Petition

81-1177

No. 81-

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1981

CAPITOL INDUSTRIES-EMI, INC.,
Petitioner,

vs.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT PRIOR TO ENTRY OF DECISION IN THAT COURT AND WHILE CASE IS PENDING THEREIN

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QUESTIONS PRESENTED

1. Whether Section 1341, Title 28, United States Code, removes from the federal court's jurisdiction a suit to enjoin and restrain the assessment and collection of a California Franchise tax, where it is not "plain" that the complainant has any judicial remedies available to it in the California courts, and it is clear that there is no remedy in the California courts which will permit it to contest the amount of the tax. It is not contended that this issue is the one which justifies intervention of this Court prior to decision in the Court of Appeals under the standards explained in Rule 18 of the Rules of this Court.

2. May the State of California burden foreign commerce by extending the combined unitary income formula (hereinafter "combined formula") which it applies to an American corporation to include the income, property and wages of its United Kingdom parent corporation and the latter's 71 non-U.S. subsidiaries operating world wide, which have foreign commerce with the United States but which do no business in any state of the United States, which do not have a permanent establishment in the United States, which are not subject to taxation by the United States Government under either the Internal Revenue Code or the United States-United Kingdom Income Tax Convention, and where the effect of the State's application of its formula is to apportion some of the income of the nonresident United Kingdom corporation and its non-United States subsidiaries to the American subsidiary for taxation by California where:

(a) The entire income of the United Kingdom corporation and of its non-U.S. subsidiaries, all of which

is included in the combined unit California would apportion, has already been taxed in full by the United Kingdom and the other host countries, and California allows neither a deduction for those taxes nor a credit for them against its own tax, thus producing multiple taxation of income earned in foreign commerce; and

(b) The income of petitioner, the American subsidiary, is swollen by the apportionment to it of some of the income of the United Kingdom parent and its non-U.S. subsidiaries, far beyond any conceivable earning capacity of the American subsidiary from the conduct of its own business; and

(c) The apportionment of the combined net income by the three-factor formula of the ratio of California property, payroll and sales to the combined worldwide property, payroll and sales of the United Kingdom parent and its seventy-six subsidiaries, is made on the basis of estimates, first because the Official Secrets Act of the United Kingdom prohibits the United Kingdom corporations from revealing some of the information essential to the application of the California formula, and second because the wages paid by the non-U.K. subsidiaries are not reported to the United Kingdom parent and are for years before California made its demand and cannot now be assembled; and

(d) There is no uniformity between the economic environment in which the American subsidiary operates and those in which the non-U.S. corporations operate, most notably because the wage rates in the United

States for the years before the Court are higher than those which prevail in the countries in which the corporations which California would consolidate operate, with the result that each factor in the formula is weighted to apportion more net income to California than could be earned in that state by the business conducted in it, such income being therefore derived from that properly taxable by the United Kingdom and the other foreign countries where the businesses are conducted; and

(e) where the businesses of the United Kingdom parent, its non-U.S. subsidiaries, and the American subsidiary which are being combined consist primarily of the recording in each country of music popular in and often peculiar to that country, the making of records and tapes in the country in which the recording was made, and the sale of those records and tapes to the residents of that country, but sales of records in foreign commerce are made by both the U.K. parent and petitioner, the American subsidiary, to customers of their choice, and under a reciprocal matrix exchange agreement both the U.K. parent and the American subsidiary make records of music initially recorded by the other; and

(f) where the effect of the California formula is to tax to petitioner, the American subsidiary, income earned and received exclusively abroad by other corporations from business conducted locally in other countries or in foreign commerce, which income California would not have jurisdiction over directly because of International Law, of the United States-

United Kingdom Income Tax Convention, and of Section 381, Title 15, United States Code.

3. Does the United States-United Kingdom Income Tax Convention in effect in the years 1968-1974, although conferring benefits only on United Kingdom corporations, represent part of the International law the States must observe in taxing an American subsidiary of a United Kingdom parent corporation, where under the treaty the United States as contracting party cannot tax any of the income of the United Kingdom parent because it does not have a permanent establishment in the United States?

PARTIES TO THE PROCEEDINGS BELOW

There is no other party to this proceeding. EMI Limited is a party to a companion but unconsolidated case which was joined in the Court of Appeals for argument. It will be affected by the outcome. A petition for certiorari has been filed in that case.

EMI Limited stock is owned in the United Kingdom.

Petitioner has no partially owned subsidiaries.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT PRIOR TO ENTRY OF DECISION IN THAT COURT AND WHILE CASE IS PENDING THEREIN

Capitol Industries-EMI, Inc., a Delaware corporation, plaintiff in the United States District Court and appellant in the United States Court of Appeals for the Ninth Circuit, Docket No. 80-4113, petitions for a Writ of Certiorari under Rule 18 to review the case now pending in and not yet decided by the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

There is no opinion of the Court of Appeals. The opinion of the District Court is not officially reported, but is appended hereto in Appendix A.

JURISDICTION

The jurisdiction of this Court is invoked under Section 2101(e) of Title 28, United States Code. No decision has yet been rendered by the United States Court of Appeals, where the case was argued and submitted for decision on October 15, 1981. The decision of the District Court, Northern District of California, granting summary judgment to defendants was entered on February 12, 1980, and Notice of Appeal was filed by plaintiff-appellant on March 4, 1980. Plaintiff-Appellant's opening brief on appeal was filed July 16, 1980. All briefs were filed before the end of 1980.

The jurisdiction of the federal court was invoked under Sections 1331 and 2201, Title 28, United States Code. Plaintiff does not have a plain, speedy and efficient judicial remedy available to it in the California courts, and for that reason the provisions of Section 1341, Title 28, United States Code, do not remove this case from the jurisdiction of the federal courts.

STATUTES, CONSTITUTIONAL PROVISIONS AND TREATIES INVOLVED

1. The sections of the Judicial Code involved are Sections 1331, 1341 and 2201, Title 28, United States Code. They are set forth verbatim in Appendix B.

2. The sections of the United States Constitution involved are the Commerce Clause (Art. I, Sec. 8, cl. 3), the Import-Export Clause (Art. I, Sec. 10, cl. 2), and Art. I, Sec. 8, cl. 1 and 10, and Art. I, Sec. 10, cl. 1 and 3; and Art. II, Sec. 2, cl. 1 and 2, Art. III, Sec. 2, cl. 1 and 2,

and Sec. 3, cl. 1 and 2, and Art. VI, cl. 2 and 17. All are set forth in Appendix C.

3. The United States-United Kingdom Income Tax Convention in effect in the years involved in this case. The text of the relevant provisions is set forth in full in Appendix D.

4. Section 381 of Title 15, United States Code, is also involved. Its text is set forth in Appendix E.

STATEMENT OF THE CASE

This case is one to restrain defendant tax officials of the State of California from assessing a tax against plaintiff, Capitol Industries-EMI, Inc., on a portion of the income of its parent, EMI Limited, and the latter's 71 non-US subsidiaries from their business done exclusively in foreign and local commerce from and in the United Kingdom and other foreign countries, in violation of a federal treaty, statute and constitutional law.

Petitioner Capitol Industries-EMI, Inc., is a Delaware corporation, and is a subsidiary of EMI Limited. That corporation is a United Kingdom corporation which owns all or substantially all of the stock of 76 subsidiary corporations, some of which are formed under the laws of the United Kingdom, and others of which are formed under the laws of the various countries in which they operate. They operate in and are formed under the laws of more than 30 countries in Western Europe, North America, the Near East and the Far East of Asia, South America, Africa, and Australasia. Capitol Industries-EMI, Inc. (hereinafter "Capitol"), is one such subsidiary, and has

been since EMI Limited acquired a majority of its stock in 1956. Capitol has its principal office and plant in Hollywood, California, and has other plants in Illinois, Virginia and Connecticut.

Capitol makes and sells phonograph records and pre-recorded tapes of music recorded in its studios and in independent studios by artists under contract to it. These artists are selected by Capitol, and the music recorded is selected by Capitol, or by Capitol and the artists. EMI has no role in Capitol's selections of artist or music. Capitol sells its records nationally and internationally, through outlets with whom it establishes contractual relationship. Its sales are to the trade. It also has its own licensees in foreign countries who make and sell records in their countries from Capitol matrices. EMI Limited does not direct or participate in any of these activities and arrangements.

EMI Limited does not do business in the United States and does not have a permanent establishment in this country. It is therefore not subject to United States tax by treaty. In its corporate self it does no business outside of the United Kingdom. EMI's worldwide subsidiaries make approximately 20% of all of the phonograph records made in the Western world and own pressing plants located in 13 countries. Capitol in the United States owns three of these plants. In addition to that type of music business, through subsidiaries operating in several countries, but not in the United States, the EMI group is in the business of retailing phonograph records and pre-recorded tapes, and sheet music.

Subsidiaries of EMI also operate a variety of other businesses: the manufacture of television cameras, antennae and transmission equipment, and of security devices; the operation of a movie studio at which both television films and films for the theater are made; the operation of movie theaters, bingo parlors, hotels, restaurants, and places of amusement; the manufacture for the government of the United Kingdom and certain governments of NATO of military equipment, much of which employs radar principles pioneered and in some instances invented by EMI, and the development and production of equipment in the field of medical electronics, the most notable of which is the invention and patenting of the brain scanner and body scanner. Capitol conducts no business other than the making of phonograph records and pre-recorded tapes, and at times the manufacture and sale of raw tape for use by other recording companies.

EMI does operate in foreign commerce between the United Kingdom and the United States. Its subsidiaries sell completed phonograph records to an unrelated United States outlet, but not to Capitol. It and its subsidiaries have a matrix exchange agreement with Capitol, modeled closely after the one which EMI Limited had with RCA before EMI acquired controlling interest in Capitol, under which each party has an option to license a duplicate matrix of recordings made by the other, to make recordings of the music embedded on that matrix and to sell them in their marketing areas. This agreement is entirely reciprocal, giving EMI precisely the same rights in respect to matrices of music recorded by Capitol as it gives Capitol for matrices made by EMI. The agreement confers

an option right on each party, and does not bind either party to take any of the matrix offerings of the other. The license fees and other amounts paid for the privilege are entirely reciprocal, so that the amounts paid by Capitol to EMI are the same as the amounts paid by EMI to Capitol, per unit manufactured.

Both EMI and Capitol contend that they are not engaged together in a single unitary business, and that the income of each can be readily ascertained by the arm's length method used by the United States Government under Section 482 of the Internal Revenue Code, and by all foreign governments. They also contend that taxing Capitol on an apportioned amount of EMI's income represents a forbidden burden on foreign commerce, contrary to the Constitution of the United States, and contrary to International law, to the United States-United Kingdom Income Tax Convention, and to Section 381, Title 15, United States Code.

Defendants initiated their audit of Capitol's returns by demanding information of EMI Limited, threatening it with monetary penalties if it did not reply. EMI informed them that it was not within the jurisdiction of California, could not supply some of the information sought because of restrictions of the Official Secrets Act of the United Kingdom, and did not possess other of the information sought because it was not supplied to EMI by EMI's non-U.K. subsidiaries. Defendants then made the same request for information of Capitol, with the same threat of a penalty, and Capitol informed defendants that it could not supply information about EMI which it could

not get from EMI. Defendants' employees then compiled figures about EMI available from public sources in the United States, and assessed a proposed additional tax against Capitol based upon what they believed to be the total net income of EMI and all of its worldwide subsidiaries, and an apportionment of it to California based upon the ratio which the California property, payroll and sales of Capitol bore to what defendants estimated was the total worldwide property, payroll and sales of EMI and its subsidiaries. The non-U.K., non-U.S. property and payroll figures were unknown and defendants substituted their estimates. Capitol protested this action, conferences were held by Capitol representatives with defendants and their representatives, and those representatives informed Capitol that defendants would adhere to their position, until such time as Capitol provided the information defendants had sought from EMI. Plaintiff EMI Limited, and Capitol Industries-EMI, Inc., both then filed cases in the United States District Court for the Northern District of California against the defendants, to restrain such an assessment against Capitol, and in EMI's case to restrain defendants from lessening the value of EMI's investment in the United States, through the assertion of unconstitutional taxes from Capitol, from burdening EMI's foreign commerce with the United States, and for other relief.

Cross-motions for summary judgment were filed, in petitioner's motion supported by extensive affidavits of officers of EMI and Capitol, and documentary exhibits. While these cases were pending, defendants' representatives proposed to Capitol's representatives that defendants would change the basis of assessment, to combine Capitol

only with EMI's music business. Capitol's representatives informed defendants' representatives that the information they needed for such a modified combination and apportionment was not available, so the representatives of defendants devised figures based upon assumptions and estimates and employed those in the apportionment formula in substitution for the figures that they had previously used, which had been their estimate of the entire worldwide business of EMI Limited. The effect was to reduce the deficiency, but a deficiency in excess of $400,000 still remains in issue for the years determined by defendants, and an unknown but certain amount for later years. On December 7, 1981, while this case was submitted and awaiting decision in the Court of Appeals, defendants mailed notices of final assessment so computed. Petitioner has sought a stay in the Court of Appeals.

The District Court rendered summary judgment for defendants, holding that plaintiff Capitol had an adequate remedy in the California courts, and EMI must be satisfied with Capitol's remedy. Capitol has at best an imperfect remedy which is not a "plain, speedy and efficient" remedy in the California courts, and it is not disputed by defendants that EMI has none at all. Appeal was taken, and the issues were briefed both on the jurisdictional point and on the merits, oral argument was had in both cases and on both aspects, and the cases are awaiting decision.

This petition before judgment below is filed to enable this Court, if it so desires, to add a case involving a foreign parent in a multi-national group of corporations with American subsidiaries to those cases which it will consider,

involving the Constitutional validity of combination of domestic parents with their foreign subsidiaries and the apportionment of the combined income, or in two cases, the application of apportionment formulae to the dividend income of American parent corporations, paid to them by foreign affiliates from their business conducted either in foreign countries or in foreign commerce between the United States and foreign countries.

REASONS FOR GRANTING THE WRIT

1. This Court has accepted jurisdiction of three cases[1] presenting various aspects of the constitutional issues raised by the application of their combined apportionment formulae by states to foreign source income of foreign subsidiaries of domestic parent corporations. The Court has scheduled them for argument at this Term. The urgency of this case is that it presents another, and vitally important aspect of the same problem: viz, the application of such combined apportionment formulae to the foreign source income of foreign parent corporations with an American subsidiary. This aspect of the problem should be considered while the Court is considering the other cases. Considerations unique where there is a foreign parent, such as treaties, double taxation of the before-tax income, and the fact the foreign source income of foreign parents will never be paid into the United States, and will never be within the reach of the United States, are considerations

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[1] *Asarco Inc. v. Idaho State Tax Commission*, No. 80-2015, Oct. Term 1981; *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., Illinois Department of Revenue*, No. 81-349, Oct. Term 1981; *F. W. Woolworth Co. v. Taxation and Revenue Department*, No. 80-1745, Oct. Term 1981.

the Court should have presented to it on plenary argument, and will not have before it in cases involving American parent corporations.

2. There is no more serious international controversy involving the United States in the area of taxation than that which has been engendered by the insistence of certain states on applying their combined unitary apportionment formulae to foreign parent corporations and their foreign subsidiaries, and then combining them with their American subsidiaries. The President of the European Economic Community filed a protest with the Department of State against this practice, in 1980. A copy of that letter is included herewith as Appendix F. The Government of the United Kingdom also filed a letter of protest with the Department of State in 1980. A copy of that letter is included as Appendix G. Members of Parliament of the United Kingdom have gone so far as to testify before a Congressional Committee in Washington in support of bills which would prohibit states' including foreign source income of multi-national corporate groups owned by foreign corporations within their combined unitary apportionment formulae. Both of the letters referred to above were written to the Department of State after the United States Senate refused, by two votes less than the two-thirds required for approval, to approve the explicit prohibition of such practice in the new United States-United Kingdom Income Tax Convention. On December 8, 1981, the Japanese foreign trade association added its voice to the protest, thus completing the roster of the principal United States trading partners outside North America.

3. The international community has shown much more concern with the avoidance of duplication of income taxes than it has with the duplication of property taxes. There are presently 40 such treaties, either in effect between the United States and foreign countries or signed and in the process of ratification. The concern this Court expressed in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), about duplication of taxation in foreign commerce and the retaliatory effect that could be expected from permitting a state to impose taxes on foreign commerce which duplicate the tax burden imposed by the home nation, should be even greater here. The duplication of income taxation in the international sphere is an issue of much bigger international importance than was the duplication of property taxes this Court disapproved in *Japan Line*. As we will show hereafter, the retaliation which this Court foresaw would follow from the duplication of tax involved in *Japan Line*, if this Court had permitted it to occur, has already occurred in the international income tax sphere. This case and its companion case, *EMI Limited v. Bennett et al.*, are excellent vehicles for the consideration of the impact of this type of combined formula because the feared duplication of tax exists in fact, and the ultimate equity owner of the income which has been taxed twice is a foreign corporation, formed under the laws and operating in a treaty nation, and having no permanent establishment in the United States. The impact of any decision in this area involving domestically-owned multinational corporate groups cannot be fully assessed by this Court without consideration of the possible impact of such a decision on foreign parents of multinational groups which

have one or more subsidiaries operating in the United States.

4. In *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), this Court held that the constitutional tests of validity of taxes in foreign commerce differed from those in interstate commerce. Our Nation's formative history explains the necessity of that conclusion, and of the corollary the Court also adopted, that schemes of taxation which do not impermissibly burden interstate commerce may impermissibly burden foreign commerce. Hence apportionment methods valid in taxation of interstate commerce may be invalid when applied to foreign commerce, and this Court's decision in *Japan Line* held that the apportionment of property values there involved, though valid in interstate commerce, was invalid in foreign commerce.

The history we referred to suggests strongly that the prohibition against states' burdening foreign commerce is absolute. An historian contemporary to the events states that the two principal causes of the American Revolution were dissatisfaction with Parliament's control over taxes and over foreign commerce. The first governing law over the United States, the Articles of Confederation, did not substitute another central control over these subjects for the one the Continental Congress was fighting to terminate. 2 Curtis, *History of the Constitution of the United States* (Harper and Brothers, 1954), pp. 20-22; 1 Curtis, *History etc.*, pp. 148. Experience with operating under the Articles soon demonstrated that the Union would not survive long in peacetime if each state remained free to contribute to

the national treasury only whatever it chose, to regulate and to tax foreign commerce, and to make its own treaties of trade with foreign nations. 1 Curtis, *History etc.*, 179-180, 202-213, 276-277; *The Federalist XII* (Alexander Hamilton). The necessity of removing from the states all control over foreign commerce in order to preserve the Union was perceived, and was a major factor in framing the Constitution, and in gaining adherents to it. *The Federalist XLIV* (John Jay); *The Federalist XI* (James Madison); 2 Curtis, *History etc.*, pp. 11-12, 13-14 (footnotes), 23-24. There was not equal perception that the Congress should also have the power to regulate interstate commerce, but that subject was vigorously debated and the power was conferred only after the persuasion of debate. 2 Curtis, *History etc.*, pp. 289-298. Thus history shows that the Constitutional Convention was absolutely disinclined to tolerate state interference with foreign commerce, and was less concerned with state interference with interstate commerce.

It follows that the absence of Congressional legislation specifically laying down standards may imply some tolerance of state interference with interstate commerce, but none with foreign commerce.

For this reason, this Court should review the application of State formulae apportioning income of foreign subsidiaries doing all their business abroad, to domestic subsidiaries, of their foreign parents, for the States to tax. This case, where the cleavage between income earned in this country and that earned abroad is unusually distinct, is an appropriate vehicle.

5. The action defendants would take is in violation of the treaty then in effect. Although Capitol is not a direct beneficiary of the treaty, Capitol is the direct victim of its disregard. In the petition for certiorari in *EMI Limited v. Bennett et al.*, No. 81-1088, we state the basis for our interpretation of the treaty, because it is directly involved there. Taxing some of EMI's income to Capitol amounts to evading the treaty by subterfuge, and the Court should consider whether petitioner Capitol should be entitled to complain of it as one means of enforcing the treaty.

6. International law prohibits what defendants seek to do, this Court should so declare, and in this case can do so. In *Japan Line,* the property subjected to multiple taxation had nexus with California through actual physical presence. Here there is an entire absence of nexus. EMI Limited has no property of its own or office in California. Under International law ownership of the stock of Capitol does not establish the presence of EMI in every State in which Capitol operates. International law is based on custom and settled practice as much as on treaties and agreements. *The Paquete Habana,* 175 U.S. 677, 686, 708 (1900). Every state is subordinate to International law. *Banco Nacional de Cuba v. Sabbatino,* 376 U.S. 398, 425 (1964). The international custom to respect the distinction between foreign parent and domestically formed subsidiary is so thoroughly accepted that it is in each of the forty income tax treaties the United States has signed and in addition is universally respected between nations where there is no treaty. Thus, for example, Mexico and the United States, and Colombia, Venezuela, Peru, Chile and Spain and the United States.

all bilaterally recognize the custom in the absence of treaty.

The official position of the Executive about what is prevailing international custom binds the American courts (Draft Restatement of Foreign Relations Law (Revised) American Law Institute, Sec. 132 (3)). In 1977 both Secretary of the Treasury Blumenthal and Assistant Secretary Woodworth testified before the Senate Foreign Relations Committee that the California combined unitary apportionment method was contrary to "the internationally accepted approach" and "is inconsistent with accepted tax treaty policy." (Hearings Before the Senate Foreign Relations Committee, July 19, and 20, 1977, 95th Cong. 1st Sess. pp. 20-21, 412, 489-490.)

Notes from the Government of the United Kingdom and the President of the European Economic Community to the United States Department of State have spoken of the competing allocation method required by all treaties in force, known as the "arms-length basis", as the "internationally accepted" one, and have protested California's departure from it. (Appendix F, Appendix G.) The major Japanese trade association, Federation of Economic Organizations, has filed a "petition" with the Federal Government for it to prohibit the states' employment of the combined unitary method, according to a press account of December 9, 1981. (Appendix J.)

Clearly the obstinacy of California in persisting in using this asymetrical system is damaging this country's economic foreign relations.

The importance of this Court's early review of California's departure from International law, in conjunction with the three cases it is reviewing, justifies the Court's review of this case at this time.

7. In *Japan Line, Ltd. v. County of Los Angeles*, supra, this Court predicted that foreign governments would be driven to retaliate against the United States if American states were permitted to impose a duplicating tax on property already, and properly, taxed in the home country. California's tax practices typified by what defendants are seeking to do here have already produced retaliation by the United Kingdom. The new U.S.-U.K. Income Tax Convention as signed, and approved by the British Parliament, contained an express prohibition of California's combined formula as applied to United Kingdom parents and their American subsidiaries. The United States Senate approved the treaty except for that provision, which narrowly failed to obtain two-thirds approval. This required that the British Parliament ratify the treaty without that provision, which for two years it refused to do. It insisted on another revision, the Third Protocol (Appendix H), which had the effect of permitting increases in the taxation of American corporations operating in the British North Sea. This was an "additional concession to the British" for "loss of the benefits of Article 9(4)" (the prohibition of State unitary taxation). Assistant Secretary Lubick. (Appendix H, p. 35.) This retaliation is not confined to California's corporations.

There is no assurance other countries will not also retaliate against the California combined formula. There

are nine members of the EEC who joined in the denunciation of the California practice. Since one has already retaliated, it is reasonable to expect others to do so. Certainly the danger this Court foresaw if the States are free to impose multiple tax burdens on foreign commerce is present here, and this Court should review the permissibility of the California method as soon as possible.

This case provides a suitable vehicle.

8. Defendants are seeking to do by indirection what Section 381, Title 15, United States Code, says they cannot do directly. That code section prescribes the nexus necessary for tax on income derived from interstate commerce. This Court should decide that it applies also to foreign commerce, and that it cannot be avoided by the subterfuge of apportioning income of the nontaxable foreign corporation to petitioner, a domestic subsidiary, which is within reach.

This apportionment is done by a mathematical formula on the basis of a generalized theory of taxation which pays no heed to 15 U.S. Code 381. Defendants have never pointed to any unfairness or overreaching in the limited commercial relationship between Capitol and EMI, and their theory does not seek to determine if such unfairness or overreaching exists and to correct it. It is, instead, a headlong assault on the federal statute, and all other limitations on jurisdiction to tax.

9. The issue is not precluded by *Bass, Ratcliff & Gretton v. State Tax Commission,* 266 U.S. 271, (1924), which involved a single British corporation doing business in two American states. It could not have claimed pro-

tection under the treaty or 15 U.S. Code Sec. 381, neither of which was yet in effect. Its business was clearly unitary, consisting of making a product in Great Britain and selling it through offices in Illinois and New York, but it offered no evidence of a loss in New York yet claimed one because it showed a loss from its New York and Illinois business combined in its federal tax return. It had clearly submitted itself to New York jurisdiction, unlike EMI. No subterfuge to reach an exempt corporation was involved.

10. a. Section 1341, Title 28, United States Code, is not a bar to jurisdiction. It is not "plain" whether Capitol has any remedy in the California courts, but it is clear that any remedy it may have is so restricted as not to be "efficient."

Both state statute (Rev. & Tax. Code Sec. 26101) and constitution (Art. XIII, Sec. 32) forbid injunctions and declaratory relief. (Appendix I)

In a taxpayer's suit for refund of a California franchise tax assertedly excessive in amount or unconstitutional, a taxpayer cannot challenge the propriety of the calculation of net income, and cannot introduce evidence to show that it should have been less, if to do so it seeks to offer evidence or information it did not previously offer to the administrative agency. *West Publishing Co. v. McColgan*, 27 Cal.2d 705, 166 P.2d 861, 865 (1946) affirmed, 328 U.S. 823. In that case the taxpayer was permitted to raise only its constitutional objection. The California Supreme Court held that the evidence that West had not presented to the Franchise Tax Board could not be presented to the Court,

because the taxpayer had failed to exhaust its administrative remedies, and exhaustion of administrative remedies was a condition precedent to redetermining the amount of the tax. In *Consumers Lobby Against Monopolies, et al. v. Public Utility Commission,* 25 Cal.3d 891, 160 Cal.Rptr. 124, 131, the State Supreme Court recently applied it to the review of decisions of the Public Utilities Commission.

Even more recently the doctrine has been applied to foreclose consideration by the California courts of a taxpayer's constitutional contentions. *Barnes v. State Board of Equalization,* (1981) 118 Cal.App.3d 994, 173 Cal.Rptr. 742. The taxpayer contended in its refund claim and in court that its sales were not subject to the sales tax because the ultimate user was the United States. The Board demanded much data, some of which went beyond the issue the taxpayer raised and some of which did not, and the taxpayer supplied none of it. The refund claim was denied and the taxpayer brought suit in the California court based, *inter alia,* on its constitutional contention. The Board moved for summary judgment on the ground the taxpayer had no judicial remedy because by failing to supply information to the Board the taxpayer had neglected to exhaust its administrative remedies. The summary judgment sought by the State was granted, and was affirmed on appeal.

Petitioner has supplied all the information to the Franchise Tax Board it could but not all that has been asked. There are great and significant gaps in what Capitol

was able to provide either because of the restrictions of the Official Secrets Act on EMI or because the information is not available at all. Time can remove some of the former because any information the British Government reveals to the public can then be revealed in a California court. Under the *West Publishing* case, petitioner could not offer it in evidence in court.

Under the more recent *Barnes* case, the California courts would even refuse to consider Capitol's constitutional arguments, and might eject Capitol from court on a summary judgment as it did to Barnes.

This California doctrine is jurisdictional, *Barnes v. State Board*, supra, *Abelleira v. District Court of Appeal*, 17 Cal.2d 280, 109 P.2d 942 (1941), so it cannot be waived and could even be raised by the California courts *sua sponte*.

Because the doctrine is non-statutory, only in case law can its boundaries be found, and the doctrine may be even further extended in the future, but its present boundaries show that Capitol has neither a "plain" nor an "efficient" remedy in the state courts.

This Court has held that uncertainty about how the state courts will apply the state procedures prevents an apparently "efficient" procedure from being the "plain" one Sec. 1341 requires. *Atlantic Coast Line R. Co. v. Daughton*, 262 U.S. 413, 426 (1923). Later the Supreme Court held that a state remedy which was "speculative" because of "uncertainty" about the state limitations on it was not a

"plain and efficient" remedy within Sec. 1341. *Hillsborough Township v. Cromwell,* 326 U.S. 620, 625 (1946). See also *Georgia Railroad & Banking Co. v. Redwine,* 342 U.S. 299 (1952).

This Court's recent decision in *Fair Assessment in Real Estate Association, Inc. et al. v. McNary,* October Term 1981 No. 80-427, decided December 1, 1981, does not bar jurisdiction. The very premise of the decision was that the state courts did provide a "plain, speedy, and efficient remedy," and both opinions started from that premise. Since the California courts will not provide Capitol that type of remedy the decision is inapposite here.

In the *Fair Assessment* case there was no contention, or at least none the opinions reflect, that the state courts could not fairly and efficiently consider the federal issues raised. Here there is evidence in the state cases that they will so restrict the admission of evidence that later discovered evidence may not be introduced, and, even worse, that the state courts will not even consider constitutional issues because Capitol did not provide all the information the administrative agency asked for. Hence it could well be that the only issue Capitol could bring to this Court from the state courts is the constitutionality of the restricted procedure itself. Certainly it seems to teeter precariously on the verge of denial of due process.

CONCLUSION

The petition for the writ of certiorari prior to decision below should be granted.

December 18, 1981.

Respectfully submitted,

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[Appendix bound separately]

Appendix

81-1177

No. 81-

Office - Supreme Court, U.S.
FILED
DEC 23 1981
ALEXANDER L. STEVAS,
CLERK

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1981

CAPITOL INDUSTRIES-EMI, INC.,
Petitioner,

vs.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor.

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT PRIOR TO ENTRY OF DECISION IN THAT COURT AND WHILE CASE IS PENDING THEREIN

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APPENDICES

APPENDICES

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Appendix A

Opinion Below

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

CAPITOL INDUSTRIES-EMI, LIMITED Plaintiff, vs. WILLIAM M. BENNETT, et al., Defendants.	No. C-79-2145-CBR
EMI LIMITED, Plaintiff, vs. WILLIAM BENNETT, et al., Defendants.	No. C-79-2146-CBR ORDER GRANTING SUMMARY JUDGMENT

These two related cases were consolidated for the purpose of hearing cross motions for summary judgment. Plaintiff in Case No. C-79-2145-CBR, Capitol Industries-EMI, Limited

("Capitol Industries"), is a Delaware corporation with its principal place of business in California. It is the sole stockholder of Capitol Records, Inc. In the second case, No. C-79-2146-CBR, plaintiff is EMI Limited, the parent of Capitol Industries and a United Kingdom corporation which has many foreign subsidiaries and no permanent establishment in the United States. Defendants in each case are members of and the chief executive officer of the California Franchise Tax Board. At issue are the efforts of the California Franchise Tax Board to assess additional taxes on Capitol Industries based upon application of California's unitary tax, Cal.Rev.&Tax.Code §§25101 et seq., to the operations of Capitol Industries parent, EMI Limited, and its other foreign subsidiaries.

The motions for summary judgment were extensively briefed and very well argued by counsel for both parties. Indeed, the Court is most appreciative of the time and effort given by counsel to this complex matter and

the gracious attempts they made to educate the Court in the complexity of the unitary tax.

While the Court has substantial question as to the ultimate constitutionality of the California unitary tax being applied to foreign corporations with foreign subsidiaries, particularly in light of Japan Lines, Ltd. v. County of Los Angeles, ____ U.S. _____, 60 L.Ed.2d 336 (April 30, 1979), this does not entitle plaintiffs to the injunctive relief they seek. Even assuming the unconstitutionality of such a tax, the California statutes afford the taxpayer in this case, Capitol Industries, an opportunity to have any mistake rectified. A taxpayer which believes that it has been illegally overassessed may protest the additional assessment, Cal.Rev.&Tax.Code §25664. If the protest is denied, the taxpayer may file an appeal with the State Board of Equalization, Cal.Rev.&Tax.Code §25667. Finally, the taxpayer may bring an action against the Franchise Tax Board for a refund, Cal.Rev.&

Tax Code §26102. Under these circumstances, there exists a plain, speedy, efficient state remedy which precludes intervention by the federal court. Aronoff v. Franchise Tax Board, 348 F.2d 9, 11 (9 Cir. 1965). The parent, EMI Limited, argued that it had no such remedy, since it had no standing before the state administrative agencies or in the state courts. However, its interest in opposing the assessment based upon the unitary tax is identical or substantially identical to that of Capitol Industries, which does have access to state administrative agencies and state courts. Under these circumstances, the Court finds that their interests being identical, EMI Limited has in effect a plain, speedy, and efficient state remedy as to the matters of which it complains. Accordingly, the Court finds that plaintiffs have failed to exhaust their state remedies and on that ground will grant defendants' motion for summary judgment.

IT IS HEREBY ORDERED that plaintiff's motions for summary judgment are denied and defendants' motions for summary judgment are granted.

IT IS HEREBY FURTHER ORDERED that counsel for defendants shall prepare an appropriate form of judgment in accordance with this order and submit it to the Court for execution within ten (10) days.

Dated: February 4, 1980.

Charles B. Renfrew

Charles B. Renfrew
United States District Judge

APPENDIX B:

Judicial Code Sections.

Section 1331.

(a) The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States, except that no such sum or value shall be required in any such action brought against the United States, any agency thereof, or any officer or employee thereof in his official capacity.

Section 1341.

The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy, and efficient remedy may be had in the courts of such State.

Section 2101.

(e) An application to the Supreme Court for a writ of certiorari to review a case before judgment has been rendered in the court of appeals may be made at any time before judgment.

Section 2202.

In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of 1954 [26 USC § 7428], any

court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

APPENDIX C:

United States Constitution:

Article I, § 8, Cl. 3. Power of Congress to regulate Commerce.

To regulate commerce with foreign nations, and among the several States, and with the Indian tribes.

Art 1, Section 10, Cl 1

No State shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, or grant any title of nobility.

Art 1, Sec. 10, Cl 2

No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of the Congress.

Art I, Sec. 10, Cl 3

No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or

engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.

Sec. 2, Cl. 2. Treaties

He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consult, Judges of the Supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Court of Law, or in the Heads of Departments.

Art I, Sec. 8, Cl. 1

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the Common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

Art I, Sec. 8, Cl 10

To define and punish Piracies and Felonies committed on the High Seas, and Offenses against the Law of Nations.

Art III, Sec. 2, Cl 1

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority, -to all Cases affecting Ambassadors, other public Ministers and

Consuls; -to all Cases of admiralty and maritime Jurisdiction' -to Controversies to which the United States shall be a Party; -to Controversies between two or more States; - between a State and Citizens of another State; -between citizens of different States, - between citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

Art III, Sec. 2, Cl 2

In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the Supreme Court shall have original Jurisdiction. In all the other Cases before mentioned, the Supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

Art VI, Cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

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In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the Supreme Court shall have original Jurisdiction. In all the other Cases before mentioned, the Supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

Art VI, Cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

APPENDIX D:

Relevant Sections, United States-United Kingdom Income Tax Convention of 1946.

Article I.

(1) The taxes which are the subject of the present Convention are:

(a) In the case of the United States of America: the Federal income taxes, including surtaxes (hereinafter referred to as 'United States tax');

(b) In the case of the United Kingdom of Great Britain and Northern Ireland: The income tax (including surtax), the corporation tax, and the capital gains tax (hereinafter referred to as 'United Kingdom tax').

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequent to the date of signature of the present Convention by the government of any territory to which the present Convention is extended under Article XXII."

Article II.

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States means the United States of America, and when used in a geographical sense means the States,

the Territories of Alaska and of Hawaii and the District of Columbia.

(b) The term "United Kingdom" means Great Britain and Northern Ireland, excluding the Channel Islands and the Isle of Man.

(c) The terms "territory of one of the Contracting Parties" and "territory of the other Contracting Party" mean the United States or the United Kingdom as the context requires.

(d) The term "United States corporation" means a corporation, association or other like entity created or organized in or under the laws of the United States.

(e) The term "United Kingdom corporation" means any kind of juridicial person created under the laws of the United Kingdom.

(f) The terms "corporation of one Contracting Party" and "corporation of the other Contracting Party" mean a United States corporation or a United Kingdom corporation as the context requires.

(g) The term "resident of the United Kingdom" means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax. A corporation is to be

regarded as resident in the United Kingdom if its business is managed and controlled in the United Kingdom.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purpose of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not resident in the United Kingdom for the purposes of United Kingdom tax.

(i) The term "United Kingdom enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United Kingdom.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or a United Kingdom enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the Contracting Parties means a branch, management, factory or other fixed place of business, but does not

include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a bona fide commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

* * *

Article III.

(1) Industrial or commercial profits of an enterprise of one of the Contracting Parties shall be exempt from tax by the other Party unless the enterprise is

engaged in trade or business in the territory of such other Party through a permenent establishment situated therein. If such enterprise is so engaged, tax may be imposed by such Party on the industrial or commercial profits of the enterprise but only on so much of them as are directly or indirectly attributable to the permanent establishment.

(2) Where an enterprise of one of the Contracting Parties is engaged in trade or business in the territory of the other Contracting Party through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.

* * *

APPENDIX E:

Title 15;

§381.

(a) No state, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act [Sept. 14, 1959], a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to:

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) For purposes of subsection (a), a person shall not be considered to have engaged in any business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, or tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office of such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, or tangible personal property.

(d) For purposes of this section:

(1) The term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

APPENDIX F

(Letter from Ambasciata D'Italia,
Washington, D.C.)

The Italian Embassy presents its compliments to the Department of State and, on behalf of the Nine EEC Governments, of which the Italian Government has now the presidency, it has the honor to forward the attached Note on the problems of the unitary method of taxation.

The Italian Embassy welcomes the opportunity to renew to the Department of State the assurances of its highest consideration.

(Signature)

Washington, D.C.
March 19, 1980

To the
Department of State
Washington, D.C.

UNITARY TAXATION

1. Our Governments are concerned about the application to US subsidiaries of foreign companies of the unitary basis of taxation as applied in California and in varying degrees by certain other States.

2. The unitary basis makes no attempt to examine the profits generated by the subsidiary. It looks to the total profits of the worldwide operations of the group of which the subsidiary is a part, and claims a portion of those profits on the basis of the assumption that certain specified factors, such as the fixed asset values, turn-over and payroll, affect the profits of the subsidiary in the same way and to the same extent as the profits of the group as a whole, irrespective of where the corporations of the group operate. This means that, whenever the group as a whole makes a profit the subsidiary will be taxed on a portion of this profit, even if the subsidiary is actually making a loss, or in the reverse situation, that the subsidiary may not be taxed if the group as a whole has made a loss, although the subsidiary is actually in a profit making position.

3. This method is incompatible with the principles accepted by all OECD member states and recommended to all states as a basis for the taxation

of subsidiaries or permanent establishments of foreign enterprises. These principles require that a subsidiary should be taxed only on the profits it actually has made, provided that these are based on dealing at "arm's length" between the subsidiary and related enterprises, i.e. that the transactions between the subsidiary and related corporations are on the same or on a comparable basis as transactions between wholly independent parties. This is intended to arrive at a fair measure of profit and rule out artificial pricing between members of the group for the sole purpose of minimizing tax liability.

4. Unless the same basic rules for calculating taxable profits are followed generally by the main trading nations it will be impossible to achieve the essential objective of providing a consistent and coherent international tax framework for trade and investment.

5. The unitary tax basis can give rise to obviously inequable tax liabilities, and to a form of double taxation which often cannot be relieved, or can be relieved only if countries, which follow generally accepted practices, bear an unfair burden of relief.

6. Unitary taxation, because it requires worldwide reporting of the group's activities in the state where the subsidiary operates imposes very heavy compliance costs, in addition to the costs of compliance and reporting for non-US corporations in their "home countries".

7. The Federal Government uses the arms-length basis for its taxation of subsidiaries of foreign corporations.

8. The problem was addressed in the US/UK Double Taxation Treaty. Article 9(4) of the Treaty, which was supported by the Administration, would have disallowed the imposition of unitary taxes on subsidiaries of UK companies. When the Senate voted on the Treaty in 1978 the majority approved the Treaty with Article 9(4) in its original form, although the necessary two-thirds majority was not achieved. Subsequently, the Senate approved the Treaty with the necessary two-thirds majority, but subject to the reservation that Article 9(4) was not to apply for the purpose of state taxation. Article 9(4) remained in the Treaty, but only for the purpose of national taxation.

9. There are currently four relevant bills in Congress. S983, S1688, HR 5093, HR 5076, the last of which is scheduled for hearings on the 31st of March.

In the view of the strong arguments against unitary taxation, our Governments urge you to support this legislation in so far as it relates to the unitary tax issues raised above, with a view to early enactment.

Washington, D.C.
March 19, 1980

APPENDIX G

(Press Release, issued by British Embassy Information Department, 3100 Massachusetts Avenue, N.W., Washington, D.C. 20008)

UK/US DOUBLE TAXATION CONVENTION

The ratification by the Exchange of Instruments of the US/UK Double Taxation Convention took place in Washington on 25 March 1980.

The Convention enters into force on 25 April 1980.

Attached is an outline of the views which have been communicated by Her Majesty's Government to the US Administration at the time of ratification.

Contact: Mr. A S Winckler or Mr. A J Perry,
British Embassy,
Tel: 462 1340

EXHIBIT G, Continued

UK/US DOUBLE TAXATION CONVENTION

The Double Taxation Convention between the UK and the US, which was signed in London on 31 December 1975, and the three supplementary Protocols which were signed in London on 26 August, 1976, 31 March 1977 and 15 March 1979 respectively were ratified by the Exchange of Instruments in Washington on 25 March 1980.

The Convention, as amended by the Protocols, will enter into force on 25 April 1980.

The following views have been conveyed by Her Majesty's Government to the US Administration.

It is a matter of regret to Her Majesty's Government that difficulties over one aspect of the Convention, although it is an important one, should have tended to obscure the achievement of the two Governments in reaching a fair and balanced agreement.

Among double taxation treaties, that between the British and United States Governments has a pre-eminent position. The economic and financial links between the two nations are so strong and the areas covered so diverse that, apart from its intrinsic importance to the United Kingdom and the United States of America, the Convention attracts wide interest internationally and is a source of authority in its field.

Her Majesty's Government is therefore gravely concerned that as a result of the amendment resulting from the United States Senate reservation on Article 9(4) the Convention does not comprehensively restrict the application of the unitary basis of taxation. That Article in its original form would have prevented the United States Government and the individual States of the United States of America from applying this basis to United Kingdom corporate

groups which have subsidiary companies in the United States. In its final form the Article applies only for the purposes of United States federal tax, where the unitary basis is not employed, and does not cover individual States of the Union. This is not only a set-back for British corporate investment in the United States. It may also be interpreted as awarding some approval for the unitary basis of taxation and could have wider repercussions.

Her Majesty's Government is convinced that the unitary basis of taxation with combined reporting, particularly as applied in the international field, is entirely unsatisfactory. The Organisation for Economic Co-operation and Development has explored, encouraged and developed the "arm's-length" principle for regulating the taxation of multinational enterprises operating through subsidiary companies or branches. This principle requires that the subsidiary or branch should be taxed only by reference to the profits which its own activities generate. Where these activities involve transactions with related enterprises and these transactions are not on the basis which would be made between wholly independent enterprises, the profits are to be adjusted for tax purposes by reference to the independent enterprise test i.e., the "arm's-length" basis. This is intended to achieve a fair measure of the profit by cancelling the effect of any artificial pricing between related enterprises. The "arm's-length" approach has been internationally accepted and is a vital feature of double taxation conventions throughout the world.

In other parts of the world where they are already taxed, even though the local subsidiary is incurring substantial losses. On the unitary basis there is likely to be unrelieved and unrelievable double taxation. In addition the compliance costs are unacceptably high.

Apart from these inherent problems associated with the unitary tax basis, its incompatibility with the internationally accepted "arm's-length" basis would generate conflicts between the international investing and trading nations and disruption of international business if the precedent implicit in the Convention were to be followed by other countries. Unless common rules for determining the allocation of profits between different taxing jurisdictions are followed internationally it will be impossible to preserve the essential objective of providing a consistent and coherent international tax framework for business and investment, for which the United States and the United Kingdom have striven together with their fellow members of the Organisation for Economic Co-operation and Development. It is the view of Her Majesty's Government that the unitary basis, which is not a practical international alternative to the "arm's-length" basis, could undo the important and patient international work that has been achieved in regulating international tax practices, and that every effort is required to discourage the use of the extension of that basis. It is to this end that the British and United States Governments have expressly prohibited its use for the purpose of the respective national tax systems under Article 9(4); and the issue will be an important aspect of the proposed annual review of the Convention.

Her Majesty's Government has recognised, in ratifying this Convention with the approval of the United Kingdom Parliament, and in its acceptance of the United States Senate reservation against Article 9(4) of the Convention, the difficult issues raised within the United States in seeking to limit State taxing powers through the double taxation conventions of the United States. It has also recognised the importance of the Convention in its many other aspects for the two Governments and for the business and investment communities on each side. It must be emphasised however that the acceptance of the Senate reservation in no way implies approval of the unitary basis and it is the urgent request of Her Majesty's Government for the reasons given above that the Government of the United States should use its best endeavours to eliminate the international application of the unitary basis of taxation.

APPENDIX H:

(Appendix C to Letter of Transmittal of the Third Protocol to the Senate on April 12, 1979)

[43] APPENDIX C

WRITTEN RESPONSES BY WITNESSES TO QUESTIONS BY SENATORS AND COMMITTEE STAFF

Department of
The Treasury
Washington, D.C.
June 8, 1979.

HON. FRANK CHURCH
Chairman,
Committee on Foreign Relations,
U.S. Senate
Washington, D.C.

DEAR MR. CHAIRMAN: To follow-up my testimony at the June 6 hearings concerning the six tax conventions or protocols involving the United Kingdom, France, Hungary and Korea, I want to assure you that Article I of the Third Protocol of the proposed US-UK Income Tax Treaty gives full effect to the Senate's reservation on Article 9(4) of that treaty. Let me also assure you that there is no similar state tax issue in any of the other five treaties which were considered by the Committee yesterday.

Again, let me emphasize our view that each of these treaties is important to the United States and that their prompt approval is desirable.

I am also enclosing answers to the written questions submitted to me by your staff at the hearings as well as copies of my answers to questions from Senator Helms and Senator Javits.

Sincerely,

DONALD C. LUBICK,
Assistant Secretary
(Tax Policy).

Enclosures.

QUESTIONS FOR ASSISTANT SECRETARY FOR TAX POLICY DONALD C. LUBICK

* * * * *

[45] Questions 6 and 7. In the third protocol proposed to the U.S.-U.K. Income Tax Treaty, the definition of permanent establishment has been changed. Please explain the basis of this change. Were the affected U.S. drilling companies contacted concerning the proposed change? If they were contacted, please give the details of when, by whom, and what resulted from such contact. Why was the permanent establishment definition selected as the item to be changed in the tax area?

Answer. In our discussions with the British subsequent to the Senate reservation on Article 9(4) of the propsed treaty, the United Kingdom specifically requested the inclusion in the protocol of a provision clarifying their taxing rights with respect to exploration

and exploitation connection activities. This requested clarification was not unusual in light of the original negotiations in 1975 over the perma[46]nent establishment definition. In those negotiations, the United States agreed to delete from the twelve month permanent establishment exclusion contained in subparagraph (2)(f) of the proposed treaty any reference to "an installation of drilling rig or ship used or the exploration or development of natural resources" as a result of the British insistence that there be no limitation on their right to tax such activities. This deletion left the application of the permanent establishment definition to these activities somewhat uncertain, although as the United Kingdom authorities believe, a strong argument exists, that these activities could be taxed even without the clarification of the new protocol.

We agreed to the inclusion of this provision in the Third Protocol because it was reasonable to expect the British to request some additional concession for loss of the benefits of Article 9(4); because the terms of the provision were reasonable in light of our own statutory tax policy (we would generally tax these kinds of activities conducted in the United States, even if they were of a shorter duration than 30 days); and because it could be viewed as little more than a clarification of a reasonable interpretation taken by the British of their taxing rights under the proposed treaty without the protocol provision.

The drilling industry was clearly aware of the precise terms of the protocol provision at least one month prior to the signing of the

Protocol on March 15, 1979. On February 16, 1979, Mr. Arnold W. Bramlett, Chairman of the Accounting and Taxation Committee of the International Association of Drilling Contractors (IADC), wrote to the International Tax Counsel, Mr. H. David Rosenbloom, expressing general concern over the provision. Subsequently, there were telephone conversations between Mr. Rosenbloom and Mr. Bramlett in which the Treasury sought specific information as to the nature of the activities and the harm which was alleged would occur. These requests were confirmed in a letter from Mr. Rosenbloom to Mr. Bramlett on March 5, 1979, still 10 days before the Protocol was signed. To date, the Treasury has not received from the IADC, or any of its members, specific information detailing any specific adverse effects of the protocol provision.

THIRD PROTOCOL TO THE U.S.-U.K. INCOME TAX TREATY:

Question 1. Would you please summarize the British reaction to the reservation included in the Senate advice and consent to ratification last June 27, 1978, concerning Article 9(4).

Answer. The British tax authorities were unhappy with the Senate reservation concerning Article 9(4). They hoped that a modified version of Article 9(4) might be included in the treaty. When it became clear that there was no possibility of a modification which would be acceptable to all parties, they reluctantly agreed to seek Parliamentary approval of the treaty with the deletion of Article 9(4) but only after the Third Protocol is approved by

the Senate. The British authorities view some of the provisions of the Third Protocol (particularly the North Sea permanent establishment rules) as a concession for the deletion of Article 9(4). We recently reconfirmed with the British their willingness to go forward with the treaty if the protocol is approved by the Senate.

[47] Very strong objection has been raised by the United Kingdom business community to the deletion of Article 9(4). Many business and industrial groups in the United Kingdom have urged Parliament not to reapprove the treaty in the absence of the Article 9(4) provision.

The strength of these objections was confirmed by testimony at the June 6 hearings to the effect that there is a view among some Conservative Members of Parliament that the treaty should not be approved unless some solution can be found to the state taxation problem, albeit outside the treaty framework.

Question 2. Would any reservations added at this date jeopardize the Third Protocol and/or the US/UK Income Tax Treaty? If yes, please explain.

Answer. In our judgment any reservation on the Third Protocol, or any substantial delay in approval of the Protocol will seriously jeopardize the chances that the proposed US/UK Income Tax Treaty, with its very substantial benefits for U.S. taxpayers, will ever come into effect.

While we cannot speak for the United Kingdom, or predict with absolute certainty the

actions which might be taken by the British Parliament, certain facts are clear. There is strong business opposition in the United Kingdom to the treaty reservation on Article 9(4) and as time passes there is also likely concern over the growing cost of the retroactive refund to the U.S. investors of the British Advance Corporation tax (it will be over $500 million through 1979). Despite this, the British have agreed to go forward to Parliament with the treaty as long as the U.S. Senate approves the Third Protocol containing what we, and they, view as a reasonable and justifiable provision clarifying the United Kingdom's taxing rights over certain offshore activities.

Should the United States again reserve on a treaty provision important to the British, particularly one which is reasonable in light of both the domestic tax law of the United States and the history of the basic treaty, it may well provide sufficient impetus for those in the United Kingdom opposed to the treaty to secure its defeat. Prolonged delay could have a similar effect.

* * * *

THIRD PROTOCOL FURTHER AMENDING THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS, SIGNED AT LONDON ON 31 DECEMBER 1975.

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland;

Desiring to conclude a third Protocol to amend the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, signed at London on 31 December 1975, as amended by Notes exchanged at London on 13 April 1976 and by Protocols signed at London on 26 August 1976 and 31 March 1977 (hereinafter referred to as "the Convention"):

Have agreed as follows:

ARTICLE I

(1) Paragraph (2) of Article 2 (Taxes covered) shall be deleted and replaced by the following:

"(2) The existing taxes to which this Convention shall apply are:

(a) in the case of the United States, the Federal income taxes imposed by the Internal Revenue Code and the tax on insurance premiums and the tax on insurance premiums paid to foreign insurers; but (except as provided in paragraph (6) of Article 10 (Dividends) excluding the accumulated earnings tax and the personal holding tax. The foregoing taxes covered are hereinafter referred to as "United States tax";

(b) in the case of the United Kingdom, the income tax, the capital gains tax, the corporation tax, and the petroleum revenue tax. The foregoing taxes covered are hereinafter referred to as "United Kingdom tax".

(2) Paragraph (3) of Article 2 (Taxes covered) shall be deleted and replaced by the following:

"(3) This Convention shall also apply to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws."

(3) Paragraph (4) of Article 9 (Associated enterprises) shall be delated and replaced by the following:

"(4) Except as specifically provided in this Article:

(a) Where an enterprise doing business in Contracting State:

(i) is a resident of the other Contracting State; or

(ii) is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State; and

(b) where the enterprise which is a resident of the other Contracting State is a corporation, such corporation is neither:

(i) A controlled foreign corporation within the meaning of section 957 of the United States Internal Revenue Code of 1954 (as it may be amended from time to time without changing the principle thereof); nor

(ii) created or organised under the laws of the first-mentioned State or of any third State or controlled, directly or indirectly, by a corporation which is a resident of any third State; then, in determining the tax liability of the first-mentioned enterprise in the State in which it does business, such State shall not take into account the income, deductions, receipts or outgoings of a related enterprise which is a resident of the other Contracting State or of an enterprise of any third State which is related to the enterprise of the other Contracting State, except that this prohibition shall not apply where the first-mentioned enterprise is a resident of the first mentioned Contracting State, to the extent that it owns, directly or indirectly, the capital of the related enterprise."

ARTICLE II

The following new paragraph 6(A) shall be added to Article 7 (Business profits) after paragraph (6):

"(6A) The United States tax on insurance premiums paid to foreign insurers shall not be imposed on insurance on reinsurance premiums which are the receipts of a business of insurance carried on by an enterprise of the United Kingdom whether or not that business is carried on through a permanent establishment in the United States."

ARTICLE III

Paragraph (5) of Article 10 (Dividends) shall be deleted and replaced by the following:

"(5) Where a corporation which is a resident of a Contracting State (and not a resident of the other Contracting State, that other State) derives profits or income from State may not impose any tax on the dividends paid by the corporation, except insofar as such dividends are paid to a resident of that other State(and where that other State is the United States, to a national of the United States) or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base situated in that other State, even if the dividends paid consist wholly or partly of profits or income arising in that other State."

ARTICLE IV

Sub-paragraph (b) of paragraph (1) of Article 19 (Government service) shall be deleted and replaced by the following:

"(b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the recipient is a resident and a national of that State."

ARTICLE V

Paragraph (4) of Article 23 (Elimination of double taxation) shall be deleted and replaced by the following:

"(4) Notwithstanding sub-paragraph (a) of paragraph (1) of this Article, the amount of United Kingdom petroleum revenue tax allowable as a credit against United States tax shall be limited to the amount attributable to United Kingdom source taxable income in the following way, namely:

(a) The amount of United Kingdom petroleum revenue tax on income from the extraction of minerals from oil or gas wells in the United Kingdom to be allowed as a credit for a taxable year shall not exceed the amount, if any, by which the product of the maximum statutory United States tax rate applicable to a corporation for such taxable year and the amount of such income exceeds the amount of other United Kingdom tax on such income.

(b) The lesser of (i) the amount of United Kingdom petroleum revenue tax on income from the extraction of minerals from oil or gas wells in the United Kingdom that is not allowable as a credit under the preceding sub-paragraph, or (ii) 2 per cent of such income for the taxable year shall be deemed to be income taxes paid or accrued in the two preceding or five succeeding taxable years, to the extent not deemed paid or accrued in a prior taxable year, and shall be allowable as a credit in the year in which it is deemed paid or accrued subject to the limitation in sub-paragraph (a) above.

(c) The provisions of sub-paragraphs (a) and (b) shall apply, separately, mutatis mutandis (but with the deletion, in the case of (b), of the words "the lesser of (i)" and "or (ii) 2 per cent of such income for the taxable year"), to the amount of United Kingdom petroleum revenue tax on income from initial transportation, initial treatment and initial storage of minerals from oil or gas wells in the United Kingdom".

ARTICLE VI

The following new Article 27A (Offshore activities) shall be inserted after Article 27 (effect on diplomatic and consular officials and domestic laws):

"ARTICLE 27A
Offshore Activities

(1) Notwithstanding the provisions of Article 5 (Permanent establishment) and Article 14 (Independent personal services), a person who is a resident of a Contracting State and carries on activities in the other Contracting State in connection with the exploration or exploitation of the seabed and sub-soil and their natural sources situated in that other Contracting State shall be deemed to be carrying on in respect of those activities a business in that other Contracting State through a permanent establishment or fixed base situated therein.

(2) The provisions of paragraph (1) shall not apply where the activities are carried on for a period not exceeding 30 days in aggregate in any 12 month period. However, for

the purposes of this paragraph, activities carried on by any enterprise related to another enterprise shall be regarded as carried on by the enterprise to which it is related if the activities in question are substantially the same as those carried on by the last-mentioned enterprise.

(3) The provisions of Article 8 (Shipping and air transport) shall not apply to a drilling rig or any vessel the principal function of which is the performance of activities other than the transportation of goods or passengers."

ARTICLE VII

The following new paragraph (7) shall be added at the end of Article 28 (Entry into force):

"(7) Notwithstanding any provisions of the respective domestic laws of the Contracting States imposing time limits for applications for relief from tax, an application for relief under the provisions of this Convention shall have effect, and any consequential refunds of tax made, if the application is made to the competent authority concerned within three years of the end of the calendar year in which this Convention enters into force."

ARTICLE VIII

(1) This Protocol shall be ratified and the Instruments of Ratification shall be exchanged at Washington as soon as possible.

(2) This Protocol shall enter into force immediately after the expiration of 30 days following the date on which the Instruments of Ratification are exchanged and shall thereupon have effect, subject to the provisions of paragraph (3) of this Article, in accordance with Article 28 of the Convention.

(3) Notwithstanding the provisions of Article 28 (Entry into force) of the Convention, the provisions of Article 27A (Offshore activities) of the Convension (as added by Article VI of this Protocol) shall not have effect until the entry into force of this Protocol.

In witness whereof the undersigned, duly authorized thereto by their respective Governments, have signed this third Protocol.

Done in duplicate at London this 15th day of March 1979.

For the Government of the
United States of America:
ROBERT J. MORRIS

For the Government
of the United
Kingdom of Great Britain
and Northern Ireland:
EVAN LUARD

APPENDIX I

CALIFORNIA

CONSTITUTION AND STATUTES INVOLVED

CALIFORNIA REVENUE AND TAXATION CODE:

§25101.

When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120 of this chapter); provided, however, that any method of apportionment shall take into account as income derived from or attributable to sources without the state, income derived from or attributable to transportation by sea or air without the state, whether or not such transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country.

If the Franchise Tax Board reapportions net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose it to the basis upon which its reapportionment has been made.

§25102.

In the case of two or more persons, as defined in Section 19 of this code, owned or controlled directly or indirectly by the same interests, the Franchise Tax Board may permit or require the filing of a combined report and such other information as it deems necessary and is authorized to impose the tax due under this part as though the combined entire net income was that of one person, or to distribute, apportion, or allocate the gross income or deductions between or among such persons, if it determines that such consolidation, distribution, apportionment, or allocation is necessary in order to reflect the proper income of any such persons.

§26101.

No injunction or writ of mandate or other legal or equitable process shall issue in any suit, action or proceeding in any court against this State or against any officer of this State to prevent or enjoin the assessment or collection of any tax under this part.

§26102.

Except as provided in Section 26103a, after payment of the tax and denial by the Franchise Tax Board of a claim for refund, any taxpayer claiming that the tax computed and assessed against it under this part is void in whole or in part may bring an action, upon the grounds set forth in its claim for refund, against the Franchise Tax Board for the recovery of the whole or any part of the amount paid.

CALIFORNIA CONSTITUTION:

Article XIII, § 32. Process to prevent or enjoin collection of tax; action to recover tax paid.

Sec. 32. No legal or equitable proces shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature.

The Wall Street Journal
Wednesday, December 9, 1981

KYODO SAYS PETITION IS
PLANNED BY JAPANESE TO
TO END TAX BY STATES

Japan's most powerful business organization has decided to petition Washington for abolition of the so-called unitary tax imposed by some states in the U.S., the Kyodo news service said.

Under the levy, a corporation operating in a state is taxed at a rate based on the sales, profits and assets of all company operations, including those outside the state.

The group, the Federation of Economic Organizations, said the unitary tax, which exists in California, Alaska, Oregon and Illinois, hinders the flow of capital between Japan and the U.S. at a time when Japanese investment in U.S. businesses is an essential factor in reducing trade friction, Kyodo reported.

Opposition

Office - Supreme Court, U.S.
FILED
JAN 15 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-1177

In the Supreme Court of the United States

OCTOBER TERM, 1981

CAPITOL INDUSTRIES-EMI, INC.,
Plaintiff, Appellant and Petitioner,

vs.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor,
Defendants and Respondents.

On Petition for Writ of Certiorari
To the United States Court of Appeals for the Ninth Circuit
Prior to Entry of Decision in That Court and
While Case Is Pending Therein

Brief for Respondents in Opposition

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QUESTIONS PRESENTED

1. Whether 28 United States Code section 1341, in any event, bars this action.

2. Whether the Eleventh Amendment to the United States Constitution bars this action.

3. Whether the anti-injunction provisions of the California Constitution and statutes bar this action.

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No. 81-1177

In the Supreme Court of the United States

OCTOBER TERM, 1981

CAPITOL INDUSTRIES-EMI, INC.,
Plaintiff, Appellant and Petitioner,

vs.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor,
Defendants and Respondents.

On Petition for Writ of Certiorari To the United States Court of Appeals for the Ninth Circuit Prior to Entry of Decision in That Court and While Case Is Pending Therein

Brief for Respondents in Opposition

I

JURISDICTION

The technical jurisdictional requirements appear to be set forth adequately in the petition. It should be observed that petitioner's contentions were rejected by the United States District Court for the Northern District of California based upon and in conformity with the pertinent decisions of this Court and the California courts. Moreover, petitioner's

petition to this Court after oral argument but prior to decision by the Ninth Circuit Court of Appeals represents nothing more than a blatant attempt by petitioner, a corporation doing business in California, to circumvent well-established procedures for contesting taxes assessed against it by the Franchise Tax Board (hereafter "FTB") of the State of California.

II

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

1. Eleventh Amendment to the United States Constitution.

2. Section 1341, title 18, United States Code.

3. California Constitution, article XIII, section 32.

4. California Revenue and Taxation Code sections 26101, 25101, 25128 and 25137.

III

STATEMENT OF THE CASE

Prefatory Statement

As petitioner's parent did in its petition for certiorari in the companion case,[1] petitioner has egregiously misstated a crucial fact in the opening statement of its "Statement of the Case," when it states that defendant tax officials seek to assess a tax against petitioner on a portion of the income of its parent and 71 non-United States subsidiaries. (Petn. for Cert., p. 3.) First, the proposed assessment was made by the FTB of the State of California and not by any of the named defendants. Second, the proposed assessment was an assessment against petitioner based on the unitary method of taxation and *not an assessment on a*

1. *EMI, Limited v. William Bennett, et al.*, 81-1088, October Term 1981, filed on December 9, 1981.

portion of the income of petitioner's parent or related corporations.

This misstatement vividly demonstrates the complete lack of merit in petitioner's lawsuit.

1. STATEMENT OF THE CASE

In this matter, on August 15, 1979, petitioner Capitol Industries-EMI, Inc. (hereafter "Capitol") filed an action for injunctive and declaratory relief against the named defendants to prevent the FTB from assessing additional taxes against Capitol on the unitary tax method. The trial court granted defendants' motion to dismiss/summary judgment on the ground that Capitol had a "plain, speedy, and efficient state remedy" in the state court.

Capitol then appealed the decision to the Court of Appeals, Ninth Circuit, which heard oral arguments on October 15, 1981. The matter is presently pending for a decision from the said Court of Appeals.

2. FACTS OF THE CASE

The only facts which are essential to resolve this appeal are as follows:

a. Capitol is a United States corporation doing extensive business in California and elsewhere.

b. EMI Limited (hereafter "EMI") is a United Kingdom corporation, which holds over 70 percent of the outstanding shares of Capitol.

c. Capitol is a California taxpayer.

d. FTB has proposed to assess additional taxes against Capitol for the years 1968 through 1974 on the unitary method.

e. Under the unitary method, which has been upheld time and time again by the California and United States Supreme Courts, the incomes of all companies which are determined to be engaged in a unitary business are combined and apportioned according to a

formula.[2] (*Butler Bros. v. McColgan* (1942) 315 U.S. 501, affirming 17 Cal.2d 664; *Edison California Stores, Inc. v. McColgan* (1947) 30 Cal.2d 472; *Superior Oil Co. v. Franchise Tax Board* (1963) 60 Cal.2d 406 and *Chase Brass & Copper Co. v. Franchise Tax Board* (1970) 10 Cal.App.3d 496.)

f. Under the California method, the following formula is generally used to compute an individual taxpayer's California source income:

Taxpayer's property in California / Combined group's total property everywhere	=	%
Taxpayer's payroll in California / Combined group's total payroll everywhere	=	%
Taxpayer's sales in California / Combined group's total sales everywhere	=	%
Total of Three Percentages	=	%

Total of Three Percentages ÷ 3 = Average Percentage

Average Percentage x Total Combined Income = Taxpayer's California Source Income[3]

g. In this case, FTB included the combined incomes of Capitol and EMI in determining Capitol's California source income. The resulting tax deficiency was then imposed against Capitol. (Par. V of Capitol's Complaint.)

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2. California Revenue and Taxation Code section 25101 provides in part:

"When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of article 2 (commencing with section 25120 of this chapter)...."

3. California Revenue and Taxation Code section 25128 provides:

"All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three."

California Revenue and Taxation Code sections 25129 through 25136 define and provide for the computation of the property, payroll and sales factors.

h. Capitol filed a protest with FTB with respect to the proposed additional assessment. Thereafter the FTB made an adjustment and issued a revised assessment against Capitol.

i. Capitol filed a petition with the FTB under California Revenue and Taxation Code section 25137[4] for authorization to use another method of reporting the tax. The FTB denied Capitol's petition for relief under Revenue and Taxation Code section 25137 on October 1, 1981.

j. Capitol has not sought any relief before the California state courts.

k. Capitol has not paid the tax.

l. Capitol has sought a stay order from the Court of Appeals, Ninth Circuit, to enjoin FTB from collecting the tax. Such a stay has not been granted.

ARGUMENT

I

THE COURT PROPERLY GRANTED SUMMARY JUDGMENT BECAUSE THE COURT LACKED JURISDICTION

A. The Eleventh Amendment to the United States Constitution Deprives the Federal Courts of Jurisdiction in This Action and Mandates a Dismissal

Unchanged since its adoption in 1798, the Eleventh Amendment to the United States Constitution provides as follows:

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4. Revenue and Taxation Code section 25137 provides as follows:
"If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
"a. Separate accounting;
"b. The exclusion of any one or more of the factors;
"c. The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
"d. the employment of any other method to effectuate and equitable allocation and apportionment of the taxpayer's income."

> "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another State, or citizens or subjects of any foreign State."

The United States Supreme Court has consistently held that an unconsenting state is immune from suits brought in federal court by her own citizens as well as by citizens of another state. (*Hans v. Louisiana* (1890) 134 U.S. 1; *Duhane v. New Jersey* (1920) 251 U.S. 311; *Great Northern Life Insurance Co. v. Read* (1944) 322 U.S. 47; *Parden v. Terminal R. Co.* (1964) 377 U.S. 184; *Employees v. Dept. of Public Health and Welfare* (1973) 411 U.S. 279.) It is also well established that even though a state is not named a party to the action, the suit may nonetheless be barred by the Eleventh Amendment. In *Ford Motor Co. v. Dept. of Treasury* (1945) 323 U.S. 459, the Supreme Court said:

> "[W]hen the action is in essence one for the recovery of money from the state, the state is the real, substantial party in interest and is entitled to invoke its sovereign immunity from suit even though individuals are nominal defendants." *Id.* at p. 464.

Thus, the rule has evolved that a suit by private parties seeking to impose a liability which ultimately will be paid from public funds in the state treasury is barred by the Eleventh Amendment. (*Great Northern Life Insurance Co. v. Read, supra; Kennecott Copper Corp. v. Tax Comm'n* (1946) 327 U.S. 573.)

As Capitol alleges in its complaint, the defendants are members of the California FTB and its chief executive officer. And as Capitol further alleges in its complaint, defendants were merely carrying out their statutory duties as members of the FTB or as its chief executive officer. In

such an action, while the individuals may be named as nominal defendants, the treasury of the State of California will to a virtual certainty be deprived of revenue which otherwise would normally have been collected. Absent a waiver by the State of California, the Eleventh Amendment is, therefore, a bar to Capitol's action.

In deciding whether a state has waived its constitutional protection under the Eleventh Amendment, the United States Supreme Court has held that a waiver will be found only where stated "by the most express language or by such overwhelming implications from the text as [will] leave no room for any other reasonable construction." (*Murray v. Wilson Distilling Co.* (1909) 213 U.S. 151, 171.) As stated in the court's decision in *Edelman v. Jordan* (1973) 415 U.S. 651, 673:

> "We see no reason to retreat from the Court's statement in *Great Northern Life Insurance Co. v. Read,* 322 U.S. at 54 (footnote omitted): '[W]hen we are dealing with the sovereign exemption from judicial interference in the vital field of financial administration a clear declaration of the state's intention to submit its fiscal problems to other courts than those of its own creation must be found.'"

To the extent that the State of California administers the Bank and Corporation Tax Law (Rev. & Tax. Code, § 23001 et seq.), it clearly has not waived such immunity. To the contrary, the state has established in state courts a "plain, speedy, and efficient remedy" for determining whether taxes have been erroneously or illegally assessed or collected (Rev. & Tax. Code, § 25661 et seq.; § 26071 et seq.; § 26102; *Corbett v. Printers and Publishers Corp., Ltd.* (1942) 127 F.2d 195, 197; *Nevada-California Electric Corp. v. Corbett* (1938) 22 F.Supp. 951). Capitol has, therefore, failed to meet its burden of alleging or showing that the

State of California has waived its immunity from this kind of suit, or this particular suit, in federal court. (*Whitner v. Davis* (9th Cir. 1969) 410 F.2d 24, 29; *Clark v. State of Washington* (9th Cir. 1966) 366 F.2d 678, 680.)

Then in the decision of December 1, 1981 in *Fair Assessment In Real Estate Association, Inc. v. McNary* .... U.S. .... (No. 80-427), this Court again recognized the proscriptions of the Eleventh Amendment with respect to state fiscal matters notwithstanding *Ex Parte Young* (1908) 209 U.S. 123.

> "After this Court conclusively decided that federal courts *may* enjoin state officers from enforcing an unconstitutional state law, *Ex Parte Young*, 209 U.S. 123 (1908), Congress also recognized that the autonomy and fiscal stability of the States survive best when state tax systems are not subject to scrutiny in federal courts. Thus, in 1937 Congress provided: [Text of 28 U.S.C. § 1341]." (*Fair Assessment in Real Estate Association, Inc. v. McNary*, ... U.S. .... (50 Law Week 4017, 4018.)

B. 28 United States Code Section 1341 Bars the Federal District Courts from Hearing a Case Such as the Instant One

The historic rule that the federal courts will not interfere with the internal fiscal operations of the states has been codified in 28 United States Code section 1341:

> "The district courts shall not enjoin, suspend or restrain the assesment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

It is well established that 28 United States Code section 1341 is an explicit congressional limitation on the jurisdiction of the federal courts in cases which would enjoin, suspend or restrain state tax levy, assessment or collection. (*Randall v. Franchise Tax Board of the State of California*

(9th Cir. 1971) 453 F.2d 381, 382; *Bland v. McHann* (5th Cir. 1972) 463 F.2d 21, 24, cert. denied, (1973) 410 U.S. 966.) Furthermore, neither the judicial decisions nor section 1341 require that the state remedy be the best remedy available or even equal to or better than the remedy which might be available in the federal courts. (*Id.*)

In this case, the lower court held that Capitol has speedy, efficient and proper remedies before the state administrative and judicial machinery, and that its proper, speedy and efficient remedy is to have Capitol pay the tax, if any is ultimately assesed,[5] and then pursue an action in the state courts.

The California Revenue and Taxation Code provisions referred to below provide readily available and wholly effective administrative procedures for aggrieved taxpayers. Once these administrative remedies have been exhausted, the taxpayer can institute an action for a refund in the state court. This procedure has been consistently held, as a matter of law and without a single instance of deviation, to be plain, speedy and efficient as to invoke the restraints of 28 United States Code section 1341. (*Nevada-California Electric Corp. v. Corbett, supra,* 22 F.Supp. 951; *Corbett v. Printers and Publishers Corp., Ltd., supra,* 127 F.2d 195, 197.) Moreover, a taxpayer can further expedite the state administrative procedures by paying the tax, filing a claim for refund and wait for six months, and then filing a suit for refund in the state court. (Rev. & Tax. Code, §§ 26073, 26074, 26075 and 26076.) Since Capitol has not exhausted its available state administrative and judicial remedies, the action should be dismissed for lack of juris-

5. Because Capitol had not yet exhausted its administrative remedies, and administrative proceedings are still possible, the entire lawsuit may become moot if Capital prevails at the administrative level.

diction. (*Bland v. McHann, supra,* 463 F.2d 21, cert. den., 410 U.S. 966.)

In its misguided effort to support an untenable position, Capitol has been forced to rely on a group of cases which are completely inapposite. We will discuss them in the order cited by Capitol.

Georgia R. Co. v. Redwine (1952) 342 U.S. 299, centered around a Georgia ad valorem tax where the state tax refund statute was applicable to only 15 percent of the total taxes in controversy. (*Id.* at p. 303.) Here Capitol has the absolute right to file a claim and suit for refund of the entire amount paid. (Cal. Rev. & Tax. Code, § 26102.)

Hillsborough v. Cromwell (1946) 326 U.S. 620, involved a New Jersey statute where the taxpayer's state remedies were not certain. In fact the taxpayer's right of review of constitutional questions by the New Jersey judiciary was dependent on the discretionary grant of certiorari by the New Jersey Supreme Court. Capitol certainly cannot be contending that California provides only discretionary judicial review. If it is so contending, it is absolutely wrong because all taxpayers have the absolute right of judicial review of all issues by way of a suit for refund. The California and federal courts have consistently held that the suit for refund procedure furnishes the taxpayer with a plain, speedy and efficient remedy. (*Aronoff v. Franchise Tax Board* (1965) 348 F.2d 9; *Greene v. Franchise Tax Board* (1972) 27 Cal.App.3d 38; *Casey v. Bonelli* (1949) 93 Cal.App.2d 253; and *Modern Barber Col., Inc. v. California Emp. Stab. Com.* (1948) 31 Cal.2d 720.)

Next Capitol completely mischaracterizes the holding of *West Publishing Co. v. McColgan* (1946) 27 Cal.2d 705, affirmed, 328 U.S. 823. In *West Publishing,* the court was not called upon to decide the question of whether the taxpayer

could present before the trial court evidence which it had not previously presented to the administrative agency. *In fact, the plaintiff in West Publishing had flatly refused to file a tax return.* It is difficult to believe that Capitol would rely so heavily on *West Publishing* and then twist its facts in a futile effort to draw a parallel with the facts in this case. Moreover, Capitol is well aware of the fact that in California all tax refund cases are tried de novo,[6] where the plaintiff is not limited to introducing before the court only such evidence as was previously presented to the administrative agency.

The case of *Consumers Lobby Against Monopolies, et al. v. Public Utility Commission* (1979) 25 Cal.3d 891, is clearly inapplicable. Neither the facts nor the legal principles involved therein remotely resemble those at issue in this case.

Finally, in what is clearly a desperate effort to gain this Court's attention, Capitol has egregiously misstated the facts and holding of the case of *Barnes v. State Board of Equalization* (1981) 118 Cal.App.3d 994. *Barnes* clearly and simply held that if a person willfully refuses to present any facts or data to the administrative agency to support his claim for refund, he cannot file a suit for refund because he has failed to exhaust his administrative remedies.[7] Thus

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6. Capitol Records was a plaintiff in a sales tax refund case in California entitled *Capitol Records, Inc. v. State Board of Equalization*, Sacramento Superior Court No. 255286, where it engaged in extensive pretrial discovery proceedings.

7. The facts set forth in the *Barnes* decision will show that *Barnes* was not a taxpayer; he was not registered with the State Board of Equalization; and he had never paid any taxes to the State Board of Equalization. Thus, when Barnes filed a claim for refund raising both factual and legal issues, the Board requested Barnes to provide support for his contentions. Barnes refused to furnish any support. As a result the Board denied the claim for refund. Barnes then filed a suit for refund although he had refused to supply the Board with any information, including the exact amounts and dates of alleged payment of taxes.

any comparison between the situation in *Barnes* and this case is utterly meritless.

Finally, this Court's decision in *Fair Assessment In Real Estate Association, Inc. v. McNary, supra,* (No. 80-427) (50 Law Week 4017), removes any doubt that may have existed as to the propriety of the trial court's order dismissing this action. In fact, this Court ruled that Congress' intention that the federal courts defer to state court in state tax matters is not limited to actions enumerated in 28 United States Code section 1342. (*Id.*, 50 Law Week 4020.) Even the concurring opinion stressed the absolute need to exhaust state remedies. (*Id.*, 50 Law Week 4027.)

II

NO INJUNCTION MAY ISSUE NOR DECLARATORY RELIEF BE GRANTED TO PREVENT OR ENJOIN THE ASSESSMENT OR COLLECTION OF TAXES

Capitol has correctly alleged in its complaint that under California law a suit for injunction, declaratory relief or other equitable process to prevent or enjoin the assessment or collection or any taxes is forbidden.

Section 32 of article XIII of the California Constitution states:

> "No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid with interest, in such manner as may be provided by the Legislature."

In like manner, Revenue and Taxation Code section 26101 relating specifically to the assessment or collection of bank and corporation taxes states:

> "No injunction or writ of mandate or other legal or equitable process shall issue in any suit, action or proceeding in any court against this State or against any officer of this State to prevent or enjoin the assessment or collection of any tax under this part."

These provisions have been continually sustained by the courts. (*Aronoff v. Franchise Tax Board, supra,* 348 F.2d 9; *Casey v. Bonelli, supra,* 93 Cal.App.2d 253; *Modern Barber Col. Inc. v. California Emp. Stab. Com., supra,* 31 Cal.2d 720.) But Capitol's allegation does not confer federal court jurisdiction. If Capitol would pay the tax and litigate the question in the state courts just like the rest of the California taxpayers, Capitol would not have the problem with which it is faced. Equal protection and due process do not mean preferential treatment for wealthy corporations with unlimited resources to pay for protracted but clearly untenable litigation.

III

CALIFORNIA COURTS CAN AND ARE FULLY QUALIFIED TO DECIDE THE QUESTION OF THE CONSTITUTIONALITY OF THE UNITARY METHOD OF TAXATION AS APPLIED TO CAPITOL

Even in this age of profligate lawsuits, this action by Capitol is as incredible as the one brought by EMI. This is not an action involving any basic inalienable constitutional rights of a resident or citizen of the United States. Quite to the contrary. This is an action by a wealthy corporation, brought in violation of long-established law in an effort to sidestep the state court and to use the federal courts to judicially overthrow the sovereign taxation powers of the State of California.

If California's unitary method is as unconstitutional and illegal as Capitol would have this Court believe, the Cali-

fornia appellate and supreme courts would nullify it. After all, Capitol has not furnished any evidence that the California courts are not capable of understanding the law. Nor is there any evidence that the California courts would not follow the laws as interpreted by the United States Supreme Court.

Capitol's suit is also disruptive of the entire judicial process. There are recognized principles regarding the subject of contesting state taxes. In addition, there is the proscription against multiple lawsuits. In this day when the public is clamoring for less taxes and greater government efficiency, responsible persons should seek to minimize litigation. This lawsuit completely violates these principles. There is not one valid reason for a taxpayer such as Capitol to challenge a state tax in the federal courts when it has an adequate and speedy remedy in the California state courts. (*Aronoff v. Franchise Tax Board, supra,* 348 F.2d 9.) Moreover, there would be utter chaos if every disgruntled taxpayer sought to attack various state tax laws in the federal courts under the guise of some purported violation of a constitutional provision.

CONCLUSION

For the foregoing reasons, it is respectfully submitted this petition for writ of certiorari should be denied.

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